

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Scott Analyst: Roger Lackey Bill Number: SB 1805

Related Bills: See Legislative History Telephone: 845-3627 Amended Date: 05-13-2002

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Conformity To Federal Financial Disabled Suspension Of Statute Of Limitation on Claims/2001 Economic Growth and Tax Relief Reconciliation Act/Exclusion/Employer Adoption Expenses

SUMMARY

This bill would:

- permanently adopt the federal employer-provided adoption assistance income exclusion.
- extend the period of time a "financially disabled" taxpayer has to file for a income tax refund.

This is the department's first analysis of the bill.

SUMMARY OF AMENDMENTS

The May 1, 2002, amendments deleted the provisions of the bill related to technical changes to the sales and use tax law. The amendments added a new provision that would conform state law to federal law with regard to employer related adoption expenses.

The May 13, 2002 amendments added provisions to the bill related to the suspension of the SOL for financially disabled taxpayer claims for refund.

PURPOSE OF THE BILL

It is the author's intent to simplify California income tax law by providing taxpayers income tax treatment comparable to that under federal law.

EFFECTIVE/OPERATIVE DATE

The exclusion from income of employer adoption expenses would be effective and operative January 1, 2003.

The suspension of the SOL would be effective January 1, 2003, and would apply to all periods of financial disability commencing before, on, or after this date. However, it would not apply to any claim barred by the SOL as of January 1, 2003.

POSITION

Support.

At its March 6, 2002, meeting the Franchise Tax Board voted to sponsor legislation for the suspension of the SOL for financially disabled taxpayers as contained in this bill.

Board Position:

<u> X </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> PENDING

Department Director

Date

Alan Hunter for GHG

5/15/02

ANALYSIS

1. Exclusion of employer adoption expenses

FEDERAL/STATE LAW

The federal Economic Growth and Tax Relief Reconciliation Act of 2001 allows a maximum \$10,000 exclusion from the gross income of an employee for qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program, including special needs adoptions. The special need adoption provisions do not become operative until January 1, 2003.

A special needs child is an eligible child who is a citizen or resident of the United States who a state has determined: (1) cannot or should not be returned to the home of the birth parents; and (2) has a specific factor or condition (such as the child's ethnic background, age, or membership in a minority or sibling group, or the presence of factors such as medical conditions, or physical, mental, or emotional handicaps) because of which the child cannot be placed with adoptive parents without adoption assistance.

The exclusion for qualified adoption expenses including special needs adoptions is phased out ratably for taxpayers with modified adjusted gross income beginning with \$150,000. Therefore, the exclusion is not available to taxpayers with modified adjusted gross income of \$190,000 or more. Modified adjusted gross income is the sum of the taxpayer's adjusted gross income plus amounts excluded for the exclusion of income of U.S. citizens or residents living abroad. For purposes of this exclusion, modified adjusted gross income also includes all employer payments and reimbursements for adoption expenses whether or not they are taxable to the employee. The exclusion does not apply for purposes of payroll taxes. Adoption expenses paid or reimbursed by the employer under an adoption assistance program are not eligible for the adoption credit. A taxpayer may be eligible for the adoption credit for qualified adoption expenses he or she is not reimbursed for and also for the exclusion with respect to different qualified adoption expenses paid or reimbursed by his or her employer.

California conformed to the federal law prior to the Economic Growth and Tax Relief Reconciliation Act of 2001, which allowed an exclusion of a maximum of \$5,000 from an employee's income for employer-provided adoption assistance. This exclusion from income applied to amounts paid or expenses incurred on or before December 31, 2001.

THIS BILL

This bill would conform state law to federal law allowing a maximum \$10,000 exclusion from the gross income of an employee for qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program, including special need adoptions.

2. Suspension of SOL for financially disabled taxpayers.

FEDERAL/STATE LAW

Current federal law requires a taxpayer to file a claim for refund for an over payment of tax within the later of:

- three years from the date the return was required to be filed, or
- two years from the date of payment of the tax.

A refund claim that is filed after these periods is considered untimely and is disallowed.

Also, **federal law** (IRS Reform Act) suspends the SOL for certain refund claims for a period where the taxpayer is “financially disabled.” Individuals are “financially disabled” if they are unable to manage their financial affairs because of a medically determinable physical or mental impairment that is expected to result in death or to last for a continuous period of at least one year. An individual would not be considered financially disabled for any period that the individual’s spouse or any other person is legally authorized to act on that individual’s behalf in financial matters. The law does not specify a time limit on the suspension.

Current state law allows a taxpayer to file a claim for refund of tax within:

- whichever is the later of four years from the date the return was required to be filed (without regard to extensions) or one year from the date of payment of tax;
- two years from the date of a final federal determination; or
- seven years after the due date of the return in the case of bad debts, worthless securities, or erroneous inclusion of recoveries.

The California Sales and Use Tax Law, like federal law, suspends the SOL for certain refund claims for any period where the taxpayer is “financially disabled.”

However, the **California Personal Income Tax Law** does not have a “financially disabled” suspension of the SOL for income tax purposes.

THIS BILL

This bill would allow the SOL for filing claims for refund for income tax purposes to be suspended during periods where the taxpayer is “financially disabled.”

IMPLEMENTATION CONSIDERATIONS

Since this bill is no longer identified as being a tax levy, the exclusion of employer adoption expenses would be effective and operative January 1, 2003, however, the federal exclusion is operative for taxable years beginning on or after January 1, 2002. As a result, taxpayers would be unable to exclude employer adoption expenses incurred before January 1, 2003. Either SB 1805 should be amended to be a tax levy or the provisions excluding employer adoption expenses should be amended to provide that the exclusion would be operative for taxable years beginning on or after January 1, 2002.

Once the implementation consideration is resolved, implementing this bill would not significantly impact the department’s programs and operations.

LEGISLATIVE HISTORY

AB 1208 (Chesbro, 1999/2000) included the suspension of the SOL for financially disabled claimants along with numerous other items of proposed legislation. However, AB 1208 failed to move out of the Senate Appropriations Committee and, as a result, died.

AB 1633 (Ortiz, 1997/1998) also contained the suspension of the SOL for financially disabled claimants with other provisions of the IRS Restructuring and Reform Act of 1997. AB 1633 failed to pass the Assembly Appropriations Committee and subsequently died.

AB 1469 (Ortiz, 1997/1998) included suspension of the SOL for financially disabled claimants and other provisions of the IRS Restructuring and Reform Act of 1997. Governor Wilson vetoed AB 1469 because of other provisions contained in the bill.

OTHER STATES' INFORMATION

Due to the similarity in income tax laws, the department reviewed the income tax laws of the states of *Illinois, Massachusetts, Michigan, Minnesota, and New York*. The review of these states' tax laws indicates that they do not permit employer adoption expenses, or allow a suspension of the SOL based on a taxpayer being "financially disabled."

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

1. Exclusion of employer adoption expenses

Revenue Estimate

This provision of the bill is estimated to have a very minor revenue loss not exceeding \$200,000 annually starting in 2002-3.

In 2000-01 there were only 9,000 adoptions in California (Department of Social Services "Adoptions in California, Annual Statistical Report, May 2002. The portion of taxpayers that would use the exclusion is estimated to be no more than ten percent of the total number of adopting taxpayers, or only about 900 adoption cases. It was assumed that of the \$5,000 increase provided by this bill; the taxpayer would receive approximately \$2000. If this group of 900 received an additional exclusion of \$2,000 at a 9% tax rate, the impact would be approximately \$160,000.

2. Suspension of SOL for financially disabled taxpayers.

Revenue Estimate

Based on federal projections, revenue losses from additional refunds issued are as follows (enactment assumed after June 30, 2002):

For Taxable Years Beginning 1/1/2002 Assumed Enactment After 6/30/02 Fiscal Year Cash Flow (In Millions)		
2002-03	2003-04	2004-05
-\$1	-\$1	(Minor*)

* Losses less than \$500,000

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